

No. 89-1534

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In The
Supreme Court of the United States
October Term, 1989

TESLA PACKAGING INC., ORION PACKAGING,
INC. and JACEK MUCHA,

Petitioners,

vs

HERBERT E. RUBIN and PACKAGING
EQUIPMENT SYSTEMS, INC.,

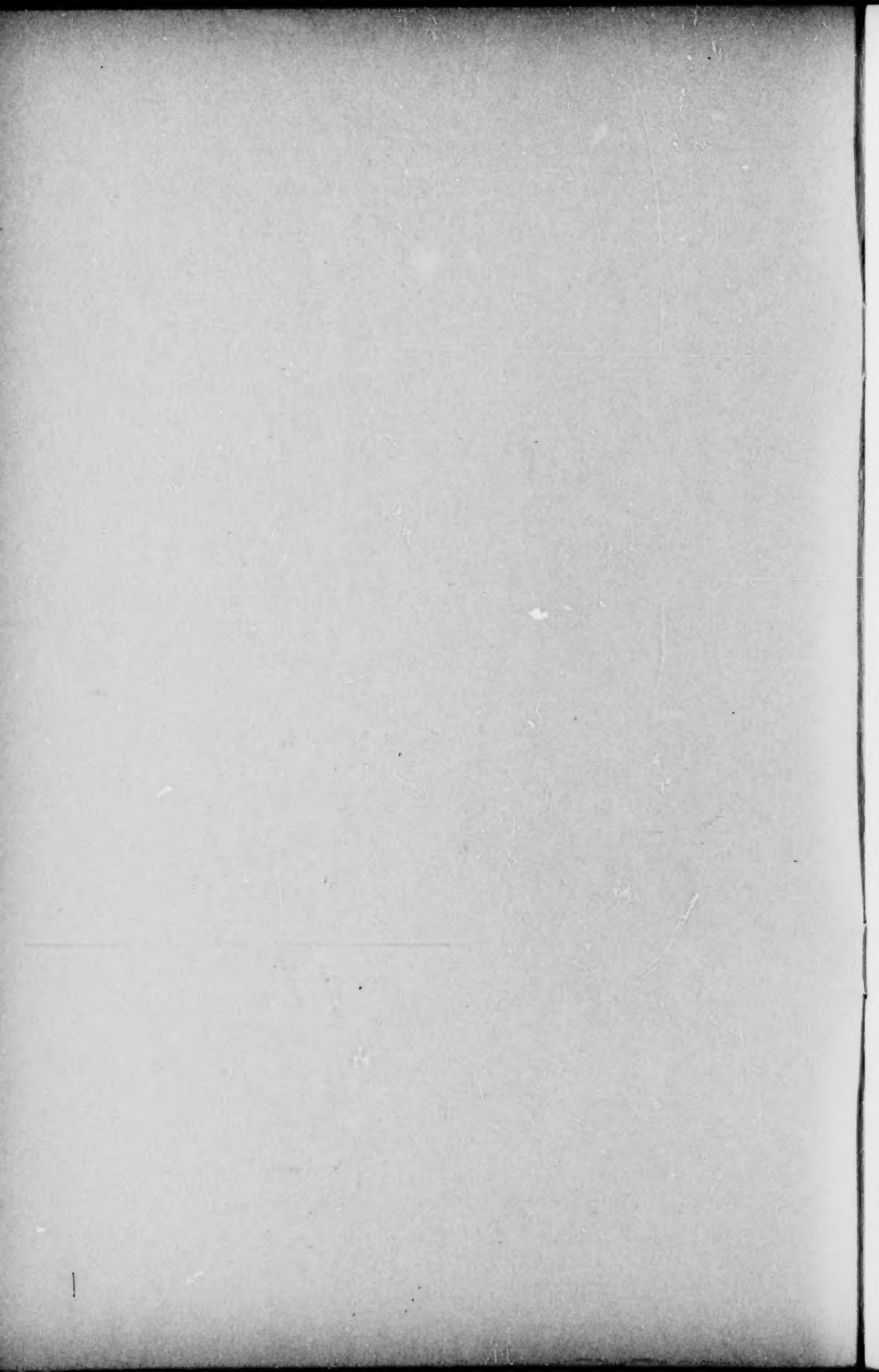
Respondents.

On Petition For Writ Of Certiorari
To The United States Court Of
Appeals For The Third Circuit

RESPONDENTS' BRIEF IN OPPOSITION
TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Petition for Writ of Certiorari alleging a "conflict" between Circuit Court decisions lacks merit, where the Third Circuit Court in this case denied recoupment under Pennsylvania law of pre-bankruptcy petition claims from post-petition claims found to be unconnected and to have arisen from different transactions, while the factually distinguishable Tenth Circuit decision concerned a single contract and followed a narrow, recognized exception permitting recoupment of mistaken overpayments?

Suggested Answer: The Petition for Writ of Certiorari lacks merit.

**RESPONDENTS' CORPORATION STATEMENT
(Pursuant to Supreme Court Rule 29.1)**

The parent corporation of Respondent Packaging Equipment Systems, Inc. is Rubin Enterprises, Inc.

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STATEMENT OF THE CASE

a. Procedural posture.

This action arose in connection with a proceeding under Chapter 11 of the United States Bankruptcy Code styled *In Re: Packaging Equipment Systems, Inc.*, No. 1-86-00885, Middle District of Pennsylvania, which was filed on August 26, 1986. The Respondents in the instant case filed a complaint against Petitioners in the United States District Court, Middle District of Pennsylvania on June 16, 1988, Docket No. 88-00920. On August 25, 1988, the Petitioners filed their Amended Answer with Affirmative Defenses and Counterclaims. Pretrial memoranda were filed by both parties on May 2, 1989 and Supplemental Pretrial Memoranda were filed by both parties; Respondent's was filed on May 10, 1989 and Petitioner's on May 15, 1989. On June 5, 1989, the parties submitted Stipulated Facts to the Court.

On June 27, 1989, Judge William W. Caldwell issued a Memorandum Opinion and Order. The Order directed that judgment be entered in favor of the Respondents in the amount of \$30,738.00, without interest, costs to be shared by the parties.

On June 27, 1989, Petitioners filed a Notice of Appeal in the United States District Court for the Middle District of Pennsylvania. On August 3, 1989, the Third Circuit Court of Appeals docketed Petitioner's appeal as No. 89-5637. By Judgment Order dated December 21, 1989, the Third Circuit Court of Appeals affirmed the decision of the United States District Court for the Middle District of Pennsylvania and awarded costs to the Respondents. Petitioners filed this appeal to the United States Supreme

Court from the Judgment Order of the Third Circuit Court of Appeals.

On March 21, 1990, Petitioners filed a Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit. The original Petition was returned for nonconformity and a second Petition was filed on March 28, 1990. This Brief is filed in Opposition to said Petition for Writ of Certiorari.

b. Statement of Facts.

This action arises in connection with a proceeding under Chapter 11 of the United States Bankruptcy Code titled *In Re: Packaging Systems, Inc.*, No. 1-86-00885, Middle District of Pennsylvania, which was filed on August 26, 1986. Packaging Equipment Systems, Inc. (hereinafter referred to as "PES") is a Pennsylvania corporation which at all times relevant to this action sold packaging equipment and supplies throughout the United States. In August of 1985, PES, through its President, Herbert E. Rubin, entered into an oral business arrangement with Petitioner, Orion Packaging, Inc. (hereinafter "Orion"), a Canadian Corporation which manufactures packaging machines through its President, Petitioner Jacek Mucha. Both parties have agreed that there existed an oral agreement providing that PES would receive a profit on sales of Orion equipment in the United States generated by PES. Under the parties' business agreement, the method used by both PES and Orion for calculating the profits/commissions PES would receive on the sales of the Orion equipment was to take the retail sales price of the machine and subtract the manufacturer's (Orion's) cost of

the machine and shipping charges. (Stipulated Fact No. 10, appendix to Petition for Writ of Certiorari, hereinafter "App.", p. 16a).

Between August of 1985 and August 26, 1986 (the date PES filed for bankruptcy protection under Chapter 11), PES sold four Orion machines to Northland Container Corporation of Michigan. (Stipulated Fact No. 1, App. at 13a). During this period it was arranged between PES and Orion that *PES would invoice* the purchasers of Orion equipment, receive payments for the equipment from the purchasers, and then pay Orion the manufacturer's cost for the equipment, plus shipping. PES would retain the remaining portions of the retail sales prices as its profits/commissions. (Stipulated Fact No. 11, App., pp. 16a-17a). The last sale prior to bankruptcy occurred in March 1986 and on June 27, 1986 PES billed Northland. (Stipulated Fact No. 6, App., pp. 14a-15a). On August 25, 1986 Northland issued a check in the sum of \$49,292.80 in payment and the next day, on August 26, 1986, PES filed its petition. The proceeds of Northland's check became part of the assets of the PES bankruptcy proceeding. (Stipulated Fact No. 8, App., p. 15a).

The parties agree that included in Northland's payment of \$49,292.80 was the sum of \$30,078.00 that PES owed Orion on account of the selling price for the machine in question. (Stipulated Fact No. 9, App., pp. 15a-16a).

After PES filed for bankruptcy under Chapter 11 on August 26, 1986, the parties agreed to the continuation of their business arrangement, although Orion required certain modifications to the parties' business arrangement.

Specifically, Orion required PES to assume responsibility for the payment of customs duties on Orion equipment shipped into the United States. In addition, after PES filed bankruptcy, *Orion began to invoice* the purchasers of Orion equipment directly, receive payments for the retail sales prices directly from the purchasers, retain its costs and shipping charges and send PES its profits/commissions for the sales (Stipulated Fact No. 12, App., p. 17a). The first modification served to reduce the PES profits/commissions by shifting the custom duty costs from Orion to PES. The second modification shifted financial control over invoicing to Orion. Orion required that invoicing of United States customers be done directly from Orion's headquarters in Canada rather than by PES.

The business relationship between the parties was nonetheless financially successful during this period of time. PES, through its marketing and sales efforts, generated substantial and growing sales of Orion equipment in the United States to various purchasers.

It was during this period of time, however, that Orion began to withhold payment of PES's profits on a number of United States sales. It is the profits/commissions on these post-bankruptcy sales for which PES sued. (Stipulated Fact No. 14, App., p. 18a).

SUMMARY OF ARGUMENT

The Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit, hereinafter "Petition," lacks merit. The Petition is based upon an

alleged "conflict" between the decision of the Third Circuit Court of Appeals in this case and the clearly distinguishable decision of the Tenth Circuit Court of Appeals in *In Re: B&L Oil Company*, 782 F.2d 155 (10th Cir. 1986) (*See*, Petition, p. 15). There is no conflict between these decisions.

The clearly distinguishable facts of the two cases establish why recoupment might have been permissible in *B&L*, while recoupment would not be proper in this case. *B&L* involved a *single* contract and followed a narrow, recognized exception permitting recoupment of mistaken overpayments. The Honorable William W. Caldwell, at the district level, distinguished *B&L* and all of the other cases cited by Petitioners as involving "instances where the debt recouped by the creditor was an integral or indivisible part of the claim made by the bankrupt, or was a recognized exception where the creditor had inadvertently overpaid the debtor, and is permitted to recoup the overpayment for which there was no consideration in the first instance." (App., p. 8a).

In contrast to *B&L*, there were no "overpayments" by Orion to PES in this case. Rather, PES owed Orion the selling price of a machine sold before the bankruptcy petition was filed. Furthermore, there was no "single contract" in this case as in *B&L*. Respondents maintain that each individual sale of equipment to each of numerous purchasers in the course of dealings between the parties constituted separate transactions. In any event, it is undeniable that the claims of PES and Orion arose from *at least two* different series of transactions – those which

occurred *before* Orion changed the sales and billing arrangements and those which occurred afterwards. There was no "single contract" as in *B&L*.

The district court so held, finding as facts that the parties' reciprocal obligations "arose from different transactions," (App., p. 7a), and that the PES pre-filing debt to Orion was "totally unconnected to the commissions earned by PES on post filing sales." (App., pp. 9a-10a). The Third Circuit Court of Appeals affirmed the district court's decision. Petitioners are, in essence, asking this Court to ignore or overrule the factual findings in this case and apply the inapplicable decision of *B&L*.

Respondents are compelled by Supreme Court Rule 15.1 to point out perceived misstatements by the Petitioners. Petitioners misstate the facts by representing to this Court that "there were no material changes throughout the business arrangement between Petitioner and Respondent. . . ." (Petition, p.11). One can hardly imagine a more significant change in the business relationship than the handling of billings and payments. In essence, the parties' business relationship changed from one where PES billed purchasers, forwarded the manufacturer's cost plus shipping to Orion, and kept the remaining monies as PES profit/commission (Stipulated Facts, Nos. 3, 11, App., pp. 14a, 16a-17a), to an Orion-controlled relationship where Orion generally invoiced purchasers directly, received payment from the purchasers directly, retained its costs and shipping charges, and was to send PES its profit/commission for the sales (Stipulated Fact No. 12, App., p. 17a). In a bankruptcy situation, where so

much hinges upon which party has the assets at the time of the bankruptcy, a change in the handling of billings and payments is most significant.

Petitioners misstate the law applicable to this case by representing to this Court that the doctrine of recoupment is to be applied when pre-petition claims and post-petition claims "arose from the same transaction or *cause of action*." (Petition, pp. 11, 12) (Emphasis added). Petitioners misstate the question for review as whether the doctrine of recoupment is applicable where "a creditor's pre-petition claim against a bankrupt debtor and a debtor's post-petition claim against a creditor *are deemed to have arisen from the same transaction or cause of action*. . . ." (Petition, p. i) (Emphasis added). *No one* (but the Petitioners) has "deemed" these claims to have arisen from the same transaction. To the contrary, these claims have been found as a matter of fact to be totally unconnected and to have arisen from different transactions. (App., pp. 7a, 9a-10a). Further more, *no one* (but the Petitioners) has "deemed" that any claim which merely arises from the same "cause of action" may be recouped. To the contrary, the law precludes Orion from recouping its claim because it did not arise from the *same transaction* as did PES's claim.

Petitioners argue that B&L "recognized the equitable aspects of the doctrine of recoupment in that a debtor-in-possession, that accepts the benefits of an executory contract, cannot do so without accepting the burdens." (Petition, p. 19). Again, this case does not involve mere overpayments, or a single contract, nor does it involve an executory contract. It involves distinct transactions which occurred on opposite sides of the "cleavage in time"

created by the bankruptcy petition. Furthermore, the Honorable William W. Caldwell did consider the equities in this case at the district court level and reasoned:

As suggested by Judge McGlynn in dealing with the facts in *Westinghouse*, PES or Orion could have terminated their arrangement when the bankruptcy proceeding was filed (or at any time for that matter) and the amount owed Orion would have been discharged in the bankruptcy. Judge McGlynn astutely observed that this result should not differ merely because PES continued to earn commissions after it declared bankruptcy. It is true PES benefitted, but Orion had nothing to lose and provided no further credit to PES. Echoing Judge McGlynn, it would be improper to permit Orion to accrue an indebtedness to PES in order to create a charge against a pre-existing debt of PES, and thus obtain a preference over other unsecured creditors.

(App., pp. 7a-8a) (Citing *Westinghouse Electric Corporation v. Fidelity and Deposit Corporation of Maryland*, 63 B.R. 18 (E.D.Pa. 1986)). Judge Caldwell clearly considered the equitable factors in this case even though this case did not involve a single, executory contract as in *B&L*. Judge Caldwell properly held that a recoupment could not be permitted.

The factual disparities between this case and *B&L* justify their respective holdings. There is no conflict between these cases, and the Petition for Writ of Certiorari has no basis.

Respondent would only add that even if there were some conflict between this case and *B&L*, that recoupment being a common law doctrine, *Lee v. Schweiker*, 739

F.2d 870, 875 (3rd Cir. 1984), the common law of Pennsylvania would apply rather than *B&L* which is a Colorado case. The law which Pennsylvania has adopted regarding recoupment is set forth in *Westinghouse Electric Corporation v. Fidelity and Deposit Corporation of Maryland*, 63 B.R. 18 (E.D. Pa. 1986), a case which is factually "on all fours" with the case at bar and which was cited as controlling by the district court. (App., p. 5a).

ARGUMENT

- a. The Petition for Writ of Certiorari lacks merit because there is no conflict between the decision of the Third Circuit Court of Appeals in this case and the clearly distinguishable decision of the Tenth Circuit Court of Appeals in *In Re: B&L Oil Company*, 782 F.2d 155 (10th Cir. 1986).

The Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit (hereinafter "Petition") lacks merit. Petitioners have failed to allege any special and important reasons for reviewing this matter on Writ of Certiorari.

The Petition is based upon an alleged "conflict" between the decision of the Third Circuit Court of Appeals in this case and a clearly distinguishable decision of the Tenth Circuit Court of Appeals in *In Re: B&L Oil Company*, 782 F.2d 155 (10th Cir. 1986) (*See*, Petition, p. 15). There is no conflict between these circuit court decisions. The clearly distinguishable facts of the two cases readily establish why recoupment might have been permissible in *B&L* while recoupment would not be proper in this case.

B&L involved two parties to an oil division order, by which the creditor, Ashland Petroleum Company, received the right to purchase unspecified amounts of crude oil that *B&L* produced. *B&L*, 782 F.2d at 156. Ashland overpaid *B&L* for oil which had been produced and delivered prior to the filing of the bankruptcy petition. After the bankruptcy petition had been filed, Ashland withheld payments for post-petition oil deliveries to try to recover its mistaken overpayments to *B&L*. The Tenth Circuit Court of Appeals recognized that any recoupment exception to the general principal that pre-petition bankruptcy debts may not be satisfied through post-petition transactions should be narrowly construed. *Id.* at 158. However, the Tenth Circuit permitted recoupment in *B&L* because the amounts to be recouped were mistaken overpayments and fell within a line of cases permitting recoupments of such mistaken overpayments. *Id.* at 158-159.

In the case at bar, there were no overpayments, mistaken or otherwise. The Honorable William W. Caldwell, at the district court level, distinguished *B&L* and all of the other cases cited by Petitioners as involving "instances where the debt recouped by the creditor was an integral or indivisible part of the claim made by the bankrupt, or was a recognized exception where the creditor has inadvertently overpaid the debtor, and is permitted to recoup the overpayment for which there was no consideration in the first instance." (App., p. 8a). In this case, the District Court determined that the reciprocal claims of Petitioners and Respondents "arose from different transactions," (App., p. 7a), and that the PES pre-

filing debt to Orion was "totally unconnected to the commissions earned by PES on post-filing sales." (App., pp. 9a-10a). In essence, Petitioners are asking this Court to ignore or overrule the factual findings in this case and apply the inapplicable decision of *B&L*. The District Court's findings of fact were clearly proper and are not subject to being overturned.

There are other facts distinguishing this case from *B&L*. Unlike *B&L*, each individual sale of equipment to each individual purchaser in the course of dealings between these parties constituted a separate and unrelated transaction. Unlike *B&L*, each transaction involving Petitioners and Respondents involved different pieces of equipment to different third parties. Each sale was unique and unrelated to any other sale. In contrast, in *B&L* creditor Ashland bought a fungible good directly from debtor *B&L*. There were no third parties, and the product being sold was always oil. Unlike *B&L*, the course of dealings between Orion and PES drastically changed after the filing of the bankruptcy petition.

Orion's unilateral alterations of the transactions following the bankruptcy petition constituted substantially more than a mere change in "office process" as Petitioners would have this Court believe. (See, Petition, p. 8). The parties' business relationship changed from one where PES billed purchasers, forwarded the manufacturer's cost plus shipping to Orion, and kept the remaining monies as PES's profit/commission (Stipulated Facts Nos. 3, 11, App., pp. 14a, 16a-17a), to an Orion-controlled relationship where Orion generally invoiced purchasers directly, received payment from the purchasers directly, retained its costs and shipping charges, and was to send

PES its profit/commission for the sales (Stipulated Fact No. 12, App., p. 17a). In a bankruptcy situation, where so much hinges upon which party has the assets at the time of the bankruptcy, a more significant change in business relationships can hardly be imagined. While Respondents maintain that each sale constituted a separate transaction, it is undeniable that there were *at least two* different series of transactions – those which occurred *before* Orion changed the sales and billing arrangement and those which occurred afterwards.

Pursuant to Supreme Court Rule 15.1, Respondents are compelled to point out that not only have Petitioners misstated the facts by representing to this Court that “there were no material changes throughout the business arrangement between Petitioner and Respondent . . . ” (Petition, p. 11), but they have additionally misrepresented the law. Petitioners state, “ . . . the post-bankruptcy sales of Respondent should be construed as emanating from the same transaction *or cause of action*, thereby allowing recoupment of Petitioners’ pre-petition claims against Respondents’ post-petition claims”. (Petition, p. 19) (Emphasis added). Again, in their question for review, Petitioners suggest that recoupment is to be applied when “a creditor’s pre-petition claim against a bankrupt debtor and a debtor’s post-petition claim against a creditor are deemed to have arisen from the same transaction *or cause of action* . . . ” (Petition, p. i) (Emphasis added). Petitioners’ argument makes no sense. A claim can arise from the same “cause of action” without arising from the “same transaction.” If Petitioners’ argument was correct, pre-petition obligations could be recouped from post-petition obligations arising from different transactions and the doctrine of set-off adopted

by the Bankruptcy Code at Section 553, 11 U.S.C. § 553, would be rendered practically meaningless. There would be no need to limit set-off to pre-petition claims.

Clearly Petitioners' argument misstates the law. The law does *not* permit recoupment of claims which have merely arisen from the same cause of action, as Petitioners argue. To the contrary, *Collier on Bankruptcy* states that recoupment is, "the setting up of a demand arising from the *same transaction* as the plaintiff's claim or cause of action, strictly for the purpose of abatement or reduction of such claim." 4 *Collier on Bankruptcy*, Section 553.03 at page 553-13 (15th Ed. 1988) (Note omitted) (Some emphasis added). The doctrine of recoupment strictly requires that the claims arise from the same *transaction*, not just the same "cause of action": "Recoupment has thus been traditionally applied narrowly and is restricted to the *precise same transaction* in which the claim is made." *In Re Melvin*, 75 B.R. 952, 959 (Bkrtcy. E.D.Pa. 1987) (Emphasis added) (Citations omitted). Orion cannot recoup its claim because its claim did not arise from the *same transaction* as did PES's claim.

In the district court, having found that the parties' reciprocal obligations were totally unconnected and arose from different transactions (App., pp. 7a, 9a-10a), Judge Caldwell properly refused to permit a recoupment by Orion because it would give Orion an improper preferential treatment over the other creditors in violation of 11 U.S.C. Section 553 (App., p. 10a).

Petitioners suggest that the *B&L* court, "recognized the equitable aspects of the doctrine of recoupment in that a debtor-in-possession, that accepts the benefits of an

executory contract, cannot do so without accepting the burdens." Petitioners point out that Orion was the only creditor with whom Respondents continued to do business after filing the bankruptcy petition. (See, Petition, p. 19). Again, Petitioners misstate the facts by suggesting that this case involves a single contract or an executory contract. But furthermore, the Honorable William W. Caldwell fully considered the equities of this case at the district level, and he reasoned:

As suggested by Judge McGlynn in dealing with the facts in *Westinghouse*, PES or Orion could have terminated their arrangement when the bankruptcy proceeding was filed (or at any time for that matter) and the amount owed Orion would have been discharged in the bankruptcy. Judge McGlynn astutely observed that this result should not differ merely because PES continued to earn commissions after it declared bankruptcy. It is true PES benefitted, but Orion had nothing to lose and provided no further credit to PES. Echoing Judge McGlynn, it would be improper to permit Orion to accrue an indebtedness to PES in order to create a charge against a pre-existing debt of PES, and thus obtain a preference over other unsecured creditors.

(App., pp. 7a-8a) (Citing *Westinghouse Electric Corporation v. Fidelity and Deposit Corporation of Maryland*, 63 B.R. 18 (E.D.Pa. 1986)). Judge Caldwell clearly considered the equitable factors in this case even though this case did not involve a single, executory contract as did *B&L*. Judge Caldwell properly held that a recoupment could not be permitted.

The factual disparities between this case and *B&L* justify their respective holdings. There is no conflict between these cases and the Petition for Writ of Certiorari has no basis.

- b. Even if there were any conflict between this decision and the decision of another Federal Court of Appeals, recoupment is a common law doctrine, and the law of Pennsylvania as set forth in *Westinghouse Electric Corporation v. Fidelity and Deposit Corporation of Maryland*, 63 B.R. 18 (E.D.Pa. 1986) is controlling.**

As discussed in section "a" above, the source of Petitioners' discontent is the findings of fact by the District Court, affirmed by the Third Circuit Court of Appeals, that the parties' reciprocal claims arose from different transactions and were completely unrelated. However, to the extent that Petitioners argue that there is any conflict between the law as set forth in this case and *B&L*, they are asking this Court to overrule the common law of Pennsylvania in favor of that of Colorado. The *Erie* doctrine is axiomatic: there is no federal general common law and our federal courts apply the common law of the state. *Erie R. Co. v. Tompkins*, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938). Unlike "set-off", the doctrine of recoupment was a common law doctrine which was adopted by decision rather than statute. *Lee v. Schweiker*, 739 F.2d 870, 875 (3rd Cir. 1984). Thus, in this case, it is Pennsylvania's common law of recoupment which applies rather than Colorado's common law. The law which Pennsylvania has adopted regarding recoupment is as set forth in *Westinghouse Electric Corporation v. Fidelity and Deposit Corporation of Maryland*, 63 B.R. 18 (E.D.Pa. 1986),

a case which is factually "on all fours" with the case at bar and which was cited as controlling by the District Court. (App., p. 5a).

Judge Caldwell clearly and thoroughly reviewed the *Westinghouse* case in his Memorandum. The Appellants have not cited any contrary Pennsylvania authority, and Judge Caldwell found the *B&L* case to be factually distinct from this case. (See, App., p. 8a). Judge Caldwell properly applied the Pennsylvania law as set forth in *Westinghouse* to this case, rather than the law of Colorado as set forth in the factually distinguishable case of *B&L*.

CONCLUSION

WHEREFORE, Respondent prays that this Honorable Court deny the Petition for Writ of Certiorari.

Respectfully submitted,

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